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**BEFORE THE
OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE
TRADE POLICY STAFF COMMITTEE**

**SECTION 203 INVESTIGATION
OF CERTAIN STEEL**

**PROPOSAL ON ADJUSTMENT ACTIONS
CONCERNING TOOL STEEL**

**Filed on Behalf of:
Latrobe Steel Company and Allegheny Ludlum Corporation**

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I. INTRODUCTION AND EXECUTIVE SUMMARY

This proposal concerning actions intended to be taken to facilitate the positive adjustment to import competition is submitted pursuant to the Office of the United States Trade Representative's Federal Register notice of October 26, 2001 (66 Fed. Reg. 54,321), on behalf of Latrobe Steel Company ("Latrobe") and Allegheny Ludlum Corporation ("Allegheny Ludlum"), domestic producers of tool steel (collectively, "the domestic industry").

It should be noted that certain matters discussed in these comments are limited in their specificity because certain data relevant to those matters cannot be cited in this proceeding, as they involve business proprietary information ("BPI") from the record of the U.S. International Trade Commission's ("Commission" or "ITC") investigation and the domestic industry is not permitted to use that BPI outside of the ITC's proceeding. Where BPI is used in this proceeding, it is information pertaining to either Latrobe or Allegheny Ludlum, only, for which proprietary treatment is sought, below.

With respect to current problems affecting the tool steel industry's ability to compete with imports,

- the ITC properly found that tool steel is being imported into the United States in such "increased quantities" as to be a substantial cause of serious injury, or threat thereof, to the domestic tool steel industry. The record of the Commission's investigation shows that total imports of tool steel increased both absolutely and relatively over the period of investigation. Imports increased steadily from 1996 to 2000 by 46.5 percent and continued to increase in the first half of 2001, and the domestic industry lost significant market share to imports, despite an increase in apparent consumption.
- The serious injury suffered by the domestic industry is also reflected in the industry's deteriorating financial performance during the POI. As a result, there has been a significant idling of production facilities and plant closures. Further, the domestic producers' declining profits have made it difficult to raise necessary capital as demonstrated by the significant reductions in capital expenditures in recent years.

Increased imports at low prices have severely depressed domestic prices and have resulted in significant lost sales.

- U.S. importers' inventories have grown rapidly in recent years, and the domestic industry's financial condition and employment have all deteriorated to inadequate levels, as did capital expenditures.
- Imports are the overwhelming cause of the domestic tool steel industry's serious injury. Surging imports have displaced domestic producers' shipments and lower-priced imports have severely depressed U.S. producers' prices, which have resulted in lost sales.

The actions that would be undertaken during a period of import relief to improve its ability to compete after relief terminates, or to facilitate adjustment to import competition include

- improving the industry's innovation;
- continuing the development of new products so as to increase demand for tool steel;
- support for and participation in efforts to remove structural impediments to a fair market environment, including reduction of excess and inefficient capacity worldwide and elimination of government-sponsored, trade distortive, programs; and
- specific capital and non-capital projects that Latrobe and Allegheny Ludlum would like to undertake if they are provided a period of effective relief.

With respect to the types of actions the federal government can take to assist the domestic tool steel industry's efforts to enhance its competitiveness or adjust to import competition, the domestic industry asks the TPSC to recommend to the President a remedy that includes a three-year quota program combined with a one-year tariff in the first year of relief, and a surge mechanism to ensure that the program's effectiveness is not undermined by a flood of imports in the quarter prior to imposition of import relief.

Finally, this proposal explains how import relief will assist in achieving these objectives. Latrobe and Allegheny Ludlum believe they would increase capital spending to levels required to

strengthen the competitiveness of, and restore health to, the domestic industry, enable the industry to implement its adjustment plan, and have an overall positive economic impact.

II. REQUEST FOR CONFIDENTIAL TREATMENT

Pursuant to the provisions of 15 C.F.R. § 2003.6, the domestic industry requests confidential treatment for the information contained within brackets in this submission. The information contained within brackets is the type of information that is routinely given confidential treatment (and has been given confidential treatment in the Steel 201 investigation) by the ITC, as it pertains to Latrobe's and Allegheny Ludlum's business operations and plans for capital investments, which is highly sensitive information and would cause harm to Latrobe and Allegheny Ludlum if this information were made available to the public. Because this information is that of only two companies, it cannot be summarized in a non-confidential manner except as to indicate the nature of the information involved which, as stated above, involves information as to the companies' internal business operations, capital investment plans, and amounts of spending associated with those plans.

The domestic industry requests that the bracketed information contained in these comments be kept confidential and exempt from disclosure under the Freedom of Information Act (FOIA, 5 U.S.C. § 552) as business proprietary information. If the Office of the United States Trade Representative or the TPSC is considering disclosure of certain information contained in these submissions pursuant to a FOIA request, then the domestic industry asks that it be informed immediately so that it may withdraw the submission or redact confidential portions.

III. COMMENTS

A. Assessment of Current Problems Affecting the Tool Steel Industry's Ability to Compete With Imports

- the ITC properly found that tool steel is being imported into the United States in such "increased quantities" as to be a substantial cause of serious injury, or threat thereof, to the domestic tool steel industry. The record of the Commission's investigation shows that total imports of tool steel increased both absolutely and relatively over the period of investigation. Imports increased from 1996 to 2000 by 46.5 percent and continued to increase in the first half of 2001, and the domestic industry lost significant market share to imports, despite a decrease in apparent consumption.
- Although U.S. production remained fairly flat during 1996-2000, production dropped significantly between the interim 2000 and 2001 periods. Several U.S. producers exited the industry over the POI. As a result of these declines, U.S. producers' capacity utilization dropped during the POI. This decline in capacity utilization is directly correlated to the domestic industry's loss of market share.
- U.S. commercial shipments, both in terms of quantity and value, declined as imports increased substantially during the POI. Employment also dropped significantly, and wages paid those employees fell.
- The serious injury suffered by the domestic industry is also reflected in the industry's deteriorating financial performance during the POI. As a result, there has been a significant idling of production facilities and plant closures. Further, the domestic producers' declining profits have made it difficult to raise necessary capital as demonstrated by the significant reductions in capital expenditures in recent years. Increased imports at low prices have severely depressed domestic prices and have resulted in significant lost sales.
- U.S. importers' inventories have grown rapidly in recent years, and the domestic industry's financial condition and employment have all deteriorated to inadequate levels, as did capital expenditures.
- Imports are the overwhelming cause of the domestic tool steel industry's serious injury. Surging imports have displaced domestic producers' shipments and lower-priced imports have severely depressed U.S. producers' prices, which have resulted in lost sales.

B. Actions Proposed to be Taken During a Period of Relief to Improve Ability to Compete After Relief Terminates or to Facilitate Adjustment to Increased Import Competition

The domestic industry respectfully submits this plan to improve its ability to compete after relief terminates or to facilitate its positive adjustment to import competition. The domestic tool steel industry has expended substantial resources to improve its domestic and international competitiveness in a market environment that has been characterized by structural overcapacity – particularly overseas – and a tendency on the part of the industry's foreign competitors to engage in unfair pricing in the U.S. market for tool steel. The environment has also been distorted by the actions of governments in certain steel producing nations, in extending generous subsidies to local steel producing entities.

The domestic industry has committed substantial resources to restructuring its operations so as to improve productivity. It has invested considerable sums in research, development, and new equipment to maintain its position as the most modern and competitive producers of tool steel in the world. Maintaining this position is especially important, given that domestic producers of these products are major source of critical materials for the national defense effort. With the recent devastating onslaught of imports, however, these efforts have proven insufficient to ensure the industry's long-term survival.

The granting of import relief will curb the serious injury suffered by U.S. producers of tool steel and provide those producers with a period of stable market conditions. During that period, the industry will be able to have the resources – and the confidence – to invest in its future and to improve further its competitive position. This adjustment plan details some of the existing projects,

as well as some of the significant new initiatives that will be undertaken during a period of import relief.

The industry's adjustment plans involve a number of components, including: (1) improving industry innovation, efficiency, product quality, and overall cost competitiveness; (2) continuing the development of new products and applications so as to increase demand for tool steel; and (3) support for and participation in efforts to remove the structural impediments to a fair market environment, including reduction of excess and inefficient capacity worldwide and elimination of government-sponsored, trade distortive programs. With improved efficiency, increased demand, and a market free from structural impediments, the industry will be able to compete more effectively with imports at the conclusion of the relief period, thereby ensuring its ultimate survival.

1. Adjustment Efforts Through the President's Steel Program

On June 5, 2001 the President announced a three-pronged initiative to restore market forces to world steel markets and eliminate the practices that harm the domestic steel industry and its workers. The first element of that policy is the section 201 investigation. The other two elements include the initiation of negotiations which (1) seek the elimination of inefficient excess capacity in the steel industry worldwide; and (2) establish rules that will govern steel trade in the future, including rules to ensure the elimination of the underlying market-distorting subsidies that led to current conditions in the first place.

No adjustment plan developed by the domestic producers can ignore the potential opportunities and benefits that could result from both sets of negotiations. No adjustment plan can succeed long term if such negotiations fail. The domestic industry supports and, where possible, intends to participate actively in these negotiations.

2. Capacity Reduction Negotiations

Domestic producers of tool steel have been the victims of structural overcapacity in the global market. President Bush's call for negotiations to reduce the excess capacity problem marks a potentially momentous opportunity for the global steel industry, including domestic producers of tool steel. The domestic tool steel industry has long suffered from the ramifications of inefficient and excess capacity offshore, which in turn has led to chronic unfair trade practices and other market distortions.

Domestic tool steel producers intend to be active private sector participants in these negotiations. The industry will provide our negotiators with a framework for evaluating on a product-specific basis what constitutes inefficient and excess capacity, including consideration of such traditional factors as cost per ton, labor hours per ton and capacity utilization. Other factors, which the industry believes should be considered in these negotiations, include identification of excess capacity; analysis of countries and regions where such excess capacity exists; analysis of exchange rates and identification of exchange rate manipulation in evaluating whether alleged cost advantages are artificial; and bringing such other factors to bear on the analysis of efficiency, including the extent of government intervention; the existence of consistent losses; the reliance upon unfair trade practices; and the recognition that there is an inherent advantage for producers in their own markets.

A willingness on the part of both the U.S. government and the governments of its trading partners to take a serious approach to these negotiations will supplement the opportunity for domestic tool steel producers to enhance their competitive position in the world market -- an opportunity that would initially arise out of an affirmative remedy recommendation in the section

201 investigation. The capacity negotiations will take time, but their success is critical to creating a permanent end to the cycle of structural overcapacity and unfair trade that has been the 50-year legacy of the domestic steel industry.

3. Elimination of Market-Distorting Practices

Much of the inefficient excess capacity that will be the target of the capacity negotiations owes its existence to the willingness of foreign governments to subsidize the creation and maintenance of such capacity. As the President noted, "Absent strict disciplines barring government support, direct or indirect, for inefficient steel-making capacity, the problems confronting the U.S. steel industry and the steel industry worldwide will only recur."

Domestic tool steel producers are highly supportive of this prong of the President's proposal. The foreign producers rarely operated under normal market economy conditions and have had the ability undersell U.S. tool steel producers, despite the U.S. advantages in market proximity and cost competitiveness.

The success of the tool steel industry's adjustment plan -- indeed, the incentive for carrying through on this plan -- will require a degree of confidence on the part of domestic tool steel producers, that they will no longer have to compete against producers who, given the support of their governments, can ignore the basic rules of the market place. A set of disciplines to govern that trade is a fundamental component of industry adjustment. These disciplines will ensure that tool steel producers, who have already invested tens of million of dollars to improve their own competitiveness, will be able to compete on a level playing field.

4. Market Development Activities

The Specialty Steel Industry of North America (SSINA), which represents domestic producers of stainless steel and tool steel, has had an active and growing market development program for the past decade. However, reflecting depressed profitability among domestic producers, the market development budget has been reduced significantly. In 2002, it is expected that the budget will be less than 50 percent of previous years' levels. Section 201 relief would allow expanded market development activities through the association or individual companies. The development of new markets is endangered as the association and individual companies are forced to cut back on market development budgets.

5. Latrobe's Company-Specific Adjustment Plan

As referenced by Hans Sack at the hearing, Latrobe Steel had previously engaged in significant capital investment prior to 1999. Tr. at 1964. If effective relief is provided, Latrobe Steel will plan on taking several additional steps in an effort to recover from the serious injury being experienced due to the high volume of imports.

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6. Allegheny Ludlum's Company-Specific Adjustment Plan

If temporary relief from imports is granted to the U.S. tool steel industry and assuming that import relief improves the profitability of the domestic producers, Allegheny will likely consider a number of equipment upgrades, personnel additions, and manufacturing process improvements. Specifically, Allegheny will consider the following capital expenditures that have been postponed due to the sharp declines in profitability caused by increased imports:

- []
- []
- []

Allegheny will also consider additional capital investments as follows:

- []
- []
- []

In addition to the above capital expenditures, import relief would also permit Allegheny to

[

]

A return to consistent reasonable profitability would provide renewed confidence on Allegheny to explore expansion of existing facilities and other existing opportunities in related areas that could strengthen Allegheny's tool steel business.

Finally, as Allegheny is [

]

If relief is granted, Allegheny would consider [

] As always, Allegheny would

consider producing any tool steel grade that our customers and the market required.

7. Summary

Domestic producers of tool steel have developed, and stand ready to commit the funds necessary to implement, significant investments in their plant and equipment that will further improve the efficiency of their operations and strengthen their ability to compete with producers of tool steel throughout the world. These additional investments will supplement the millions of dollars that domestic producers of tool steel have already made to achieve those goals.

The degree to which the adjustment plans detailed above are ultimately implemented, however, depends a great deal on the Commission's recommending and the President's implementing a comprehensive, albeit temporary, import relief program. Such an import relief program, when combined with the President's initiatives to reduce excess worldwide capacity and eliminate market-distorting practices, will provide the domestic industry with the degree of confidence necessary to

commit to these significant investments. The implementation of an effective section 201 relief program will provide a respite that will allow the domestic industry to gather itself, to make necessary investments and improvements to further strengthen its competitiveness and to position itself to compete head-to-head with imports upon the expiration of that relief program.

In the next section of these comments, the domestic industry addresses further actions that it asks the federal government to take to assist the tool steel industry's efforts to enhance its competitiveness or adjust to import competition.

C. Actions that May Be Taken by Federal Agencies or Departments to Assist the Domestic Tool Steel Industry's Efforts to Enhance its Competitiveness or Adjust to Import Competition

On October 22, 2001, three members of the Commission determined, pursuant to section 202 of the Trade Act of 1974, that increased imports of tool steel are a substantial cause of serious injury to the domestic industry. A summary of the economic data on the record clearly supports a recommendation for a strong remedy for a three-year period.

Import Volumes. Non-NAFTA imports of tool steel increased in every year of the period of investigation and by 46.5 percent between 1996 and 2000. ITC Staff Report at STAINLESS-C-6. In interim 2001, such imports increased in volume by an additional 15.5 percent. Imports of tool steel also increased their share of the U.S. market significantly over the period. From a level of 45.2 percent in 1996, non-NAFTA imports increased their penetration of the U.S. market to 54.5 percent by 2000, and to 61.6 percent in interim 2001. Id. As a result of increased imports, domestic industry market share declined by 6.5 percent points between 1996 and 2000 and an additional 8.8 points in interim 2001. Id.

Pricing Effects. Increasing imports had a significant impact on prices for tool steel in the U.S. market. For the tool steel product tracked by the Commission, domestic producer pricing fell from the beginning to the end of the period of investigation. Id. at STAINLESS-127. Such declines occurred despite consistent increases in U.S. consumption over the 1996-2000 period. Non-NAFTA imports undersold the product of the domestic industry in a significant number of possible price comparisons. Id. at STAINLESS-129.

Profitability Effects. The increase in import volumes of tool steel over the period of investigation destroyed the profitability of the domestic industry. The value of domestic industry net sales fell between 1996 and 2000 and continued to fall in interim 2001 compared to interim 2000. Id. at STAINLESS-C-6. With this fall in sales, the industry's operating profit plummeted between 1995 and 2000, dropped to a loss in interim 2001. Id.

A strong remedy that will remain in place for the three-year period is required to stem the domestic industry's decline in sales volume, prices, and profitability. The tool steel industry has not been able to operate at a reasonable profit level during the period of investigation. The adverse effects of these financial trends, which include layoffs, reduction in hours worked, unused capacity, and deferred investments, are detailed in the ITC's Staff Report. If some discipline is not imposed on the U.S. market for tool steel through the imposition of a strong remedy for a three-year period, the deterioration of the domestic industry will continue on its recent disastrous course.

Import relief will help mitigate the serious injury and provide the domestic industry with a period of stable market conditions. During the proposed three-year period of relief, the industry will have the resources and the confidence to make investments that will further strengthen its competitive position. As detailed in the adjustment plans discussed supra, the domestic industry stands ready to make capital investments that will reduce production costs and enhance product offerings. With lower production costs, the domestic industry will be able to compete more effectively with imports while offering lower prices to end users.

1. The Remedy Should Include a Three-Year Quota Program Combined with a One-Year Tariff in the First Year of Relief

In developing a remedy recommendation to the President, the TPSC should draw on the experience in the recent section 201 cases on carbon steel wire rod and circular welded carbon quality line pipe. These cases provide a number of lessons that are applicable to this proceeding with

respect to the fashioning of a remedy, including the need to base the remedy proposal on a representative period that predates the surge in imports that caused the serious injury to the domestic industry, and to take into account declining demand when calculating the level of relief necessary to offset the serious injury caused by imports.

2. The TPSC Should Recommend a Three-Year Quota and a One-Year Tariff

After careful consideration, the domestic industry has concluded that a three-year quota program combined with a one-year tariff, as discussed below, would best address the serious injury being suffered by the domestic industry and be most effective in enabling the industry to implement its adjustment plans.

Three-Year Quota and One-Year Tariff Program for Non-NAFTA Countries			
Item	Year 1	Year 2	Year 3
Quota Program ¹ (in short tons)	53,540	55,146	56,801
Tariff Program (in percent)	15	0	0

- The TPSC should recommend that a three-year quota program be imposed on non-NAFTA imports of tool steel, with the first year quota of 53,540 short tons based on the representative period 1993-1995. To prevent a flood of imports at any one time, the quota should be allocated on a quarterly basis, with only one-fourth of the annual allotment allowed to be imported during each quarter.

¹ The domestic industry may in the course of this proceeding propose further refinements within the general quota category reflecting differences in certain products comprising that category. In addition, the domestic industry may propose further requirements concerning the quota allocation among different import sources.

- The import relief should be phased down gradually over the three-year period. The TPSC should recommend that the quota level be expanded by just three percent in each year of import relief.
- The TPSC should recommend that for a period of one year an additional tariff of 15 percent be included in the remedy along with import quotas to provide immediate price relief. Because of the significant inventory levels in the U.S. market, the quota program may take a period of time to become effective. A tariff rate of 15 percent would enable the U.S. industry to raise prices before the full impact of the quota program becomes effective.
- To discourage a surge of imports immediately prior to the imposition of the remedy, the TPSC should recommend an adjustment as follows: the quota for the first quarter of the relief period would be adjusted downward by subtracting any overage of the current quarter in excess of the average of the three previous quarters. For example, imports in fourth quarter 2001 would be compared with the average imports of the first three quarters of 2001. If the volume in the fourth quarter is higher than the average, the difference would be deducted from the first quarter of quotas (e.g., first quarter 2002).

3. For the Three-Year Period, the TPSC Should Recommend a Quota Program Rather Than Other Forms of Import Relief

The proposed quota program is essential to provide the type of relief that the tool steel industry must have to recover from the serious injury and financial deterioration it has incurred over the period of investigation. The domestic industry has been hammered in the past decade by successive waves of low-priced imports. Indeed, imports increased by more than 46 percent during 1996-2000. The serious injury inflicted on the domestic industry over the period of investigation has been a direct result of this surge in imports. For the import relief to be effective, the program must restrict imports to reasonable levels so that subsequent import surges do not persist during this period of adjustment.

Import relief in the form of a quota provides the most certainty that imports will be reduced to levels that will permit domestic prices and domestic production to increase sufficiently to reverse the severe financial deterioration that the domestic industry has incurred over the period of

investigation. Quota programs can guarantee that import relief will have an impact upon the cause of the domestic industry's serious injury, which is the surge in imports of low-priced tool steel.

The recommended remedy is commensurate with the magnitude of the injury being suffered. This is not true of any other forms of relief which the TPSC may recommend under the statute. Adjustment assistance to either the steel companies or the steelworkers will not be sufficient to remedy the injury, and other types of import remedies, such as tariffs, will not provide the necessary relief. Tariffs would not provide the industry with the certainty of protection against both the low prices and the increasing quantities of imported tool steel. With the pervasive underselling by imports in the tool steel market, foreign producers have demonstrated the capacity to set their prices well below U.S. producers' prices no matter how far U.S. prices decline. This capability suggests that a large part of any tariff relief could be absorbed by foreign producers thereby limiting its effectiveness. In other words, a mechanism that merely adds a higher duty to imports will not be as effective as quotas in reducing the volume of imports of tool steel in the U.S. market. On the other hand, if a foreign producer realizes that there is a limit to the volume that can be exported to the United States, the incentive to lower prices to gain volume disappears, and the subsequent price depression in the U.S. market should ease. Furthermore, because world overcapacity has encouraged many tool steel producers to sell at whatever price is necessary to maintain high capacity utilization rates, quotas would help encourage producers to stop building excess capacity.

Additionally, the effectiveness of a tariff can be significantly mitigated during periods of currency depreciations. Currency depreciations relative to the U.S. dollar would enable foreign producers to sell at lower prices in the U.S. market than they otherwise could have, which could in some instances have the effect of nullifying a tariff. In the recent section 201 proceeding on lamb

meat, currency devaluations allowed Australian and New Zealand producers to lower their export prices to the United States significantly, notwithstanding the U.S. tariff rate quota limitations put in place as a result of the section 201 investigation. See Petitioners' Prehearing Remedy Brief (Inv. No. TA-201-3 (Lamb Meat)) at 9.

4. The Period From 1993 to 1995 Is Most Representative of Imports of Tool Steel

As previously noted, the domestic industry has based its quota proposal on the period 1993-1995. Under 19 U.S.C. § 2253(e)(4), any action proclaiming a quantitative restriction shall be based on the most recent three years that are representative of imports of such article and for which data are available, unless the President finds that the importation of a different quantity or value is clearly justified in order to prevent or remedy the serious injury.

The domestic industry believes that the 1993-1995 period is the most recent three-year period representative of imports of tool steel for the following reasons:

1. 1993 is the first full year after the termination of the voluntary restraint agreements program established in 1984. Those restraints were terminated on March 31, 1992, after which time importers of tool steel products had unfettered access to the U.S. market. Additionally, the fact that there was no relief in place over the final three quarters of 1992 enabled those importers to adjust to the termination of the program. Accordingly, 1993 would be a representative first year for determining the level of quotas under the current program.
2. The record of the ITC proceeding demonstrates that the year 2001 represents a major turning point in the demand cycle within the period of investigation. After increasing in each year from 1996 through 2000, domestic consumption of tool steel declined by 8.4 percent in 2001. From a demand perspective, the year 1992 is similar to the year 2001 in that it represents a low point in the economic demand cycle, and therefore the selection of the period of 1993-1995 is representative of a post-recessionary period and would be an

appropriate basis for the calculation of quantitative restraints for the period 2002-2004.

In sum, the selection of the 1993-1995 period is appropriately representative in that it predates the 1996-2000 surge in imports that caused the serious injury to the industry. The period is also representative in that it takes into account the current and most recent downturn in the business cycle.

5. **The Period of Relief Should Be Three Years With an Increase In Annual Quota of Three Percent in Each of the Second and Third Years**

Under 19 U.S.C. § 2253(e)(1), the TPSC may recommend a remedy of up to a period of four years. The domestic industry, however, believes that with an effective quota in place for a period of three years, the industry can more quickly adjust to the import competition that has been the substantial cause of serious injury. Critical to the effectiveness of the quota, however, is that any phasing down of the import relief, as required by 19 U.S.C. § 2253(e)(5), be limited to an expansion of the quota level to three percent a year.

Assuming that the quota is based on the 1993-1995 period, the domestic industry believes that a three-year quota is sufficient to enable the industry to adjust to import competition. As indicated by the adjustment plans discussed earlier, the industry is committed to significant capital investment over the 2002-2004 period. Accordingly, a three-year quota period is consistent with the three-year outlook reflected in the industry's adjustment proposal. Moreover, a strong three-year quota will provide the industry with what it needs most in the short term, an opportunity to recover the market share that it has lost to imports over the period of investigation. Concentrating the quota within the three-year period will expedite that process.

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Given that the domestic industry is seeking only a three-year quota, the quota needs to maintain a period of market stability during that period. This is especially critical given the excess capacity that already exists overseas to produce tool steel, and the fact that substantial additions to that capacity are planned to come on stream within the next three years. A minimal increase in the quota will ensure that this new capacity does not undermine the market stability that the quota is designed to bring about.

6. **In Addition to the Three-Year Quota Program, the TPSC Should Recommend a One-Year Tariff of 15 Percent Because of the Significant Inventory Overhang in the U.S. Market**

Although the domestic industry proposes a quota as the primary relief to remedy the surge in imports, the substantial overhang of importers' inventories in the U.S. tool steel market could delay the effectiveness of the quota program. Inventories of tool steel imports increased by 62 percent during 1996 to 2000 and continued to increase by 7 percent between the interim periods. See ITC Staff Report at STAINLESS-78. Part of the problem with any quota-based relief is that it can take an initial period of time for the market to adjust before it provides effective relief to the industry, even though over the long-term it may provide more effective relief than tariffs. For seriously injured industries, such as the tool steel industry, the first year can be the most important in getting the industry moving toward health. Relief in the first year must be designed not only to reverse the recent downward trends of the industry but to foster positive adjustment and an overall return to health of that industry. With only three years of relief typically provided to industries under section 201, immediate relief in the first year is critical, particularly price relief. For these reasons,

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the TPSC should consider special relief in the first year of any remedy package that ensures that the upward trend of the industry and that positive adjustment to trade can begin immediately. In this investigation, the domestic industry proposes a one-year tariff of 15 percent to restore U.S. prices to levels that would justify the capital expenditures required to strengthen further the competitiveness of the domestic industry.

To obtain approval of capital investments or to obtain financing for such improvements requires a showing that the investments will be justified by a return. An industry that has been characterized by declining returns during a recent period must be able to demonstrate positive business trends in order to convince shareholders, a board of directors, or a bank that a reasonable return on investment can be obtained. This is all the more difficult in a period of declining demand, as the industry is currently experiencing. The remedy during the first year must reflect these special considerations.

To this end, the TPSC should consider application of combinations of remedies to ensure an immediate benefit to the industry in the first year of relief. Such combinations of remedy are authorized in 19 U.S.C. § 2252(e)(2)(E). In addition to the three-year quota, the domestic industry is seeking additional tariffs of 15 percent on all imports during the first year of the quota. This will ensure that the industry obtains immediate price and revenue effects in the critical first year, jump-starting the relief to the industry, while relying on the quota to stabilize the market and provide long-term relief.

7. **The TPSC Should Recommend That the Quota Program Include a Surge Mechanism to Ensure that the Program's Effectiveness is not Undermined by a Flood of Imports in the Quarter Prior to the Imposition of Import Relief**

Under the statutory time frame, there is a four-month period between the Commission's injury determination and the deadline for the President to propose a final remedy. This gap affords importers ample opportunity to enter products in an effort to avoid imposition of the remedy. Such actions would threaten to undermine the effectiveness of any remedy prior to its even going into effect.

To minimize this possibility and to preserve the integrity of any remedy, the TPSC should recommend, in conjunction with the imposition of its quota, a "surge mechanism," wherein the quota for the first quarter of the relief period would be adjusted downward for any "surge" in imports occurring during the quarter preceding the imposition of relief. A surge would be defined as the quantity of imports during the quarter preceding the imposition of import relief that is over and above the average of the three previous quarters. Thus, for example, if the first quarter of 2002 is the first quarter of the quota year, an adjustment downward would be made to the quota level if imports during the fourth quarter of 2001 exceeded the average import volume during the first three quarters of 2001.

D. **How Import Relief Will Assist in Achieving Objectives**

1. The Proposed Relief Is Needed to Remedy the Industry's Injury

The proposed three-year quota program combined with a one-year tariff of 15 percent will provide much needed relief to the domestic industry by increasing market share, improving prices, and restoring profitability. A growth in domestic shipments coupled with price increases will have the effect of raising U.S. producers' revenues, thereby returning the industry to modest profitability while preserving U.S. production and employment. Once an acceptable level of profitability has been achieved, the industry will be well positioned to make the necessary investments to improve its competitive position. An effective quota program is essential to give the domestic industry an adequate amount of relief to implement the initiatives in its adjustment plan that will ultimately enable it to compete more effectively with imports.

According to the Commission's COMPAS model,² the proposed quota program would have the effect of increasing U.S. producers' shipments by 18.2 percent and prices by 4.3 percent.³ As a result, U.S. producers' revenues would increase by 23.2 percent, which would restore the domestic

² The COMPAS model is the Commission's standard econometric model used in section 201 cases to measure the potential effect of a proposed remedy. Although the domestic industry bases its projections on the COMPAS model because it is the Commission's standard model, the domestic industry notes that the model has several limitations in this investigation. First, the COMPAS model considers only the impact on the industry during the first year and not the remaining two years of any relief program. Second, perfectly competitive behavior by both domestic producers and importers is assumed. Finally, the model fails to consider dynamic efficiencies which may accrue to the domestic industry as a result of the adjustment plans. Although the COMPAS model should be used as a general guide for determining the impact of a quota on the tool steel industry, the TPSC should be mindful to include factors specific to this industry in its analysis.

³ The domestic industry assumes a supply elasticity of 3, demand elasticity of -0.25, and substitution elasticity of 5.

industry's net sales to prior levels. The projected growth in U.S. producers' shipments would result in significant improvements in capacity utilization, employment levels, and productivity. Consequently, U.S. producers' operating income margins would improve from a dismal level in interim 2001 to a more reasonable level of profit similar to that earned by the domestic industry in prior years.

The COMPAS model also indicates that U.S. importers' prices would increase by about 14.3 percent as a result of the quota program. The Commission's pricing analysis shows that imports undersold U.S. product in numerous instances by margins of underselling that reached as high as 16.5 percent. ITC Staff Report at STAINLESS-114, 129. Accordingly, the COMPAS model shows that U.S. importers' prices would increase to levels that are more in line with the U.S. producers' prices as a result of the proposed quota program.

2. The Proposed Relief Will Increase Capital Spending to Levels Required to Strengthen the Competitiveness of, and Restore Health to, the Domestic Industry

Robert M. Feinberg, Professor of Economics at American University, conducted a study concerning the relationship between import pressure and capital spending of the domestic tool steel industry. Based on questionnaire data for six companies over the full five-year period of investigation, a large and highly statistically significant impact of import prices on investment is found, after controlling for economic growth. A 14 percent increase in tool steel import prices shown in the COMPAS model would lead to a 28 percent increase in the domestic industry's capital

spending. This finding documents the beneficial effect on the industry of an effective import remedy.

3. The Proposed Relief Will Enable the Industry to Implement Its Adjustment Plan

As detailed in the adjustment plans discussed earlier, the domestic tool steel industry, if granted an effective import relief program, stands ready to implement a number of cost saving measures that will allow it to compete more effectively with imports. Domestic tool steel producers have indicated in their questionnaire responses to the ITC that they are contemplating capital expenditures that will substantially increase efficiency in their production operations. The types of capital expenditures the domestic industry has proposed were detailed earlier.

As the adjustment plans make clear, a return to profitability and an increase in cash flow are critical first steps if any of the required capital investments are to be made. Capital investment by the domestic industry was cut severely over the course of the period of investigation, as increased import penetration resulted in reduced profits for the domestic industry. Thus, the domestic industry has now experienced years of declining capital investment, a history that must be reversed if the industry is to maintain its production efficiency and competitiveness.

As noted in the adjustment plans discussed earlier, the domestic industry is prepared to make significant capital investments that it considers crucial to its ongoing strategy to reduce costs and improve efficiency. Beyond the need for an immediate improvement in profitability and cash flow, the industry also needs some assurance that the import relief will be effective and predictable. As

discussed above, it is only after a period of at least two years of profitability that manufacturers in the tool steel industry will feel sufficiently secure in making large capital investments. Assuming that the industry returns to profitability in 2002, the imposition of a three-year quota program would provide the domestic industry with the reassurance that such market conditions would continue for an additional two years, thereby providing a reasonable comfort level in the decision-making process for capital investment.

4. The Proposed Relief Would Have a Positive Economic Impact

As indicated above, the proposed quota remedy would have a beneficial effect on the domestic industry by allowing it to return to reasonable profits and to become more competitive. The proposed remedy would also have a positive impact on the communities in which tool steel facilities are located, as many of the production workers who lost their jobs over the period of investigation would be re-hired. These jobs are significant to the economic well-being of the communities in which domestic production facilities are located.

In addition, the proposed relief will lead to net benefits to consumers and the entire economy in the long term. During the three-year period of import relief, the U.S. producers will have opportunities to lower production costs and enhance their product line. These cost savings will give the U.S. producers the ability to compete more effectively with importers while offering the consumer lower prices. At the conclusion of the three-year program, price differentials between the U.S. and imported tool steel should be narrowed, with the consumer benefitting from an improved

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product line. The consumer will ultimately benefit most from a strong U.S. industry that can effectively compete with imports.

IV. CONCLUSION

For the reasons stated above, the domestic industry requests that the TPSC recommend to the President an three-year relief program comprising a three-year quota program based on the representative period 1993-95, supplemented by a 15 percent tariff on subject imports during the first year of relief, and a surge mechanism to prevent the program's effectiveness from being undermined by a flood of imports during the period prior to imposition of import relief.

Respectfully submitted,



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